Office of the Comptroller of the Currency

Interpretive Letter #749, part 2

2. A Product Does Not Become "Insurance" Because It Is Sold by Insurance Companies

Annuities are not part of the "business of insurance" simply because they have historically been offered primarily by insurance companies. The Supreme Court specifically rejected this approach to interpretation of the McCarran-Ferguson Act, stating,

> The statute did not purport to make the States supreme in regulating all the activities of insurance *companies*; its language refers not to the persons or companies who are subject to state regulation, but to laws 'regulating the *business* of insurance.' Insurance companies may do many things which are subject to paramount federal regulation; only when they are engaged in the 'business of insurance' does the statute apply.

SEC v. National Securities, Inc., 393 U.S. 453, 459-60 (1969) ("*National Securities*") (emphasis in original).

Similarly, as the Supreme Court pointed out in *VALIC*,

> [T]he sale of a product by an insurance company does not inevitably render the product insurance. For example, insurance companies have long offered loans on the security of life insurance . . . but a loan does not thereby become insurance.

130 L.Ed.2d at 750. Insurance codes and the authority of insurance regulators will naturally address the activities that insurance companies have traditionally engaged in. *National Securities* makes it clear that the business of insurance *companies* -- what insurance companies typically do, and what insurance regulators typically regulate -- is not the same as the business of insurance under the McCarran-Ferguson Act.

Even where state insurance codes cover annuities, moreover, they generally distinguish annuities from insurance. For example, the Texas Insurance Code section at issue here, Art. 21.07-1, defines a "life insurance agent" as one who sells "insurance or annuity" contracts. The definition of "life insurance company" in Art. 3.01, Sec. 1 of the Texas Insurance Code also distinguishes between insurance and annuities.

Thus, with a few isolated exceptions, courts and other legal authorities have understood the term "insurance" to refer to a contractual obligation to indemnify the insured against a risk of loss, and have accordingly classified annuities as products that are not insurance. The Supreme Court has already addressed variable annuities and found variable annuities *not* to be insurance for purposes of the McCarran-Ferguson Act. In the absence of language in the McCarran-Ferguson Act suggesting that the context somehow requires an unusual interpretation of the term "insurance," therefore, the commonly-understood meaning must prevail, and fixed as well as variable annuities should not be considered to be insurance for purposes of the McCarran-Ferguson Act.

As discussed in more detail in section D below, this result does not mean that all Texas state laws are inapplicable to annuity sales by national banks. What it does mean, however, is that state laws that purport to apply to national banks' sales of annuities must be evaluated under longstanding, judicially developed standards of federal preemption. This is a particularly appropriate result here, since the Supreme Court has directly ruled that annuity sales are authorized for national banks under their corporate banking powers pursuant to 12 U.S.C. 24(Seventh). *See VALIC, supra*.

C. "Regulating the Business of Insurance" under the McCarran-Ferguson Act

It is axiomatic that the McCarran-Ferguson Act shields from Federal preemption state laws enacted for the purpose of regulating the business of insurance in order to provide special status for laws that *do that*. When a state law does *something else*, as is the case here, where the effect of the law, if it regulates anything, is to regulate the *powers* of national banks as a class of entity, the state law is not within the scope of protection designed by the McCarran-Ferguson Act. State regulation that negates or impairs the existing corporate activity of an entire class of entity is regulation of that type of *entity*, not regulation of the *activity* that constitutes the "business of insurance." *See Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 125 L.Ed.2d 612, 629 (1993) ("'[T]he business of insurance' should be read to single out one activity from others, not to distinguish one entity from another.").

In fact, caselaw emphasizes that the McCarran-Ferguson Act should be construed narrowly, so as to avoid displacing other federal statutes and their underlying regulatory interests. *See Women in City Government United* v. *City of New York*, 515 F. Supp. 295, 303 (S.D. N.Y. 1981); *FTC* v. *Manufacturers Hanover Consumer Servs.*, 567 F. Supp. 992, 995 (E.D. Pa. 1983). This approach is particularly appropriate in this case, where the Supreme Court has specifically determined that the authority of national banks to conduct the "business of banking" includes the authority to sell both fixed and variable annuities.

The Supreme Court has stated that state laws enacted "for the purpose of regulating the business of insurance" under the McCarran-Ferguson Act are those laws "that possess the 'end, intention, or aim' of adjusting, managing, or controlling the business of insurance." *U.S. Dep't. of Treasury v. Fabe*, 508 U.S. 491, 113 S. Ct. 2202, 2210 (1993) ("*Fabe*"). As the Court emphasized in *Fabe*, "the focus of McCarran-Ferguson is upon the relationship between the insurance company and its policyholders." *Fabe*, 113 S. Ct. at 2212. In *Fabe*, the Supreme Court was concerned with whether an Ohio statute governing the priority of claims filed in a proceeding to liquidate an insolvent insurer was preempted by a federal priority statute, or was protected by the McCarran-Ferguson Act. In deciding to apply McCarran-Ferguson protections to the Ohio statute, the court considered the relationship between the insured and the insurer, and concluded that to the extent that the Ohio priority statute regulated the resolution of policyholders' claims against an insurer, it was a law enacted for the purpose of regulating the business of insurance. *Id*.

Fabe was not the first time that the Supreme Court has considered the relationship between the insured and the insurer in applying the McCarran-Ferguson Act. In *National Securities, supra*, the Court examined a state statute requiring an insurance commissioner to certify that insurance company mergers were equitable to stockholders in order to determine whether it was protected by the McCarran-Ferguson Act. Because the Court found that the effect of the statute was to protect the stockholders, not the policy holders, it concluded that the statute was not enacted for the purpose of regulating insurance. *National Securities, supra*, 393 U.S. at 459. In deciding the case, the *National Securities* Court, like the *Fabe* Court, focused upon the relationship between the insured and the insurer, observing that the core of the "business of insurance" is

> the relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement.

Id. In dicta, the Court gave as *examples* of activities that could constitute the business of insurance: fixing of rates, selling and advertising of policies, and licensing of companies and agents. 393 U.S. at 460.

Thus, under the standards set by the Supreme Court in *Fabe* and *National Securities*, licensing of agents could constitute regulation of the business of insurance *if* the licensing standards have the end result, intention or aim of adjusting, managing or controlling the relationship between insurer and insured, the types of policies issued, or their reliability, interpretation, and enforcement. The Texas state law provisions at issue here simply do none of that. They regulate neither the "transferring or spreading [of] a policyholder's risk," nor any other practice that is "an integral part of the policy relationship between the insurer and the insured." *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119, 129 (1982) ("*Pireno*"); *see also Fabe*, 113 S.Ct. at 2209, 2213-216. Rather, they deprive an entire category of entity -- national banks -- of the capacity to exercise a corporate power they possess under Federal law.

Courts of appeals that have examined state insurance laws that attempt to restrict the authorized activities of national banks have generally concluded that state law restrictions on the powers of national banks to conduct those activities do not fall within the preemption shield of the McCarran-Ferguson Act. <**NOTE:** State courts have also examined the issue of whether the McCarran-Ferguson Act protects state anti-affiliation statutes. *See First Advantage Ins., Inc. v. Green*, 652 So.2d 562 (La. Ct. App. 1995), *cert. granted, vacated and remanded*, 64 U.S.L.W. 3656 (U.S. April 1, 1996).> *See e.g.*; *Owensboro Nat'l Bank v. Stephens*, 44 F.3d 388 (6th Cir. 1994), *cert. denied*, 134 L.Ed.2d 519 (U.S. 1996) ("*Owensboro*"); *First Nat'l Bank of E. Ark. v. Taylor*, 907 F.2d 775, 780 (8th Cir.), *cert. denied*, 498 U.S. 972 (1990) (McCarran-Ferguson Act does not immunize state insurance law restrictions from preemption because sale of debt cancellation contracts by national banks is an authorized activity of national banks and does not constitute the "business of insurance" within the meaning of the McCarran-Ferguson Act); *United Auto. Ass'n v. Muir*, 792 F.2d 356 (3d Cir. 1986), *cert. denied*, 479 U.S. 1031 (1987) ("*Muir*"); *Independent Banker's Ass'n of Am. v. Heimann*, 613 F.2d 1164, 1170-71 (D.C. Cir. 1979), *cert. denied* 449 U.S. 823 (1980) (Comptroller's regulation of disposition of income from sale of credit life insurance by national banks does not fall within the McCarran-Ferguson Act's protections). Although the state statutory restrictions examined by the courts of appeals differed in certain respects, the differences in specific features of the statutes were insignificant in resolving the issue of whether the state's statutory prohibition or restriction fell within the protection of the McCarran-Ferguson Act. Of more significance to the courts in resolving the issue was whether the state statutes regulated the "business of insurance," or something else.

In *Owensboro*, the Sixth Circuit Court of Appeals examined a Kentucky statute that prohibited national banks from acting as or affiliating with insurance agents except in strictly limited circumstances. In specifically rejecting the claim that the McCarran-Ferguson Act protected the Kentucky statute from preemption, the Sixth Circuit concluded that the Kentucky statute was not a law that regulated the business of insurance. *Id.* at 392. In reaching its conclusion, the court relied upon the criteria used by the Supreme Court, in *Pireno* when it found that certain practices of the petitioner Union Labor Life Insurance Co. did not constitute the "business of insurance" for purposes of the McCarran-Ferguson Act. Thus, the *Owensboro* court considered *whether the practice or activity restricted by the statute had the effect* of transferring or spreading policyholder risk, was an integral part of the policy relationship between the insurer and the insured, and was a practice limited to entities within the insurance industry.

Owensboro, 44 F.3d at 391-92. Because the court found that the Kentucky law in no way governs the manner in which the activities constituting the "business of insurance" are conducted, the court concluded that the law was "enacted for the purpose of regulating certain conduct by bank holding companies, not the business of insurance." *Owensboro*, 44 F.3d at 392.

Similarly, in *Muir*, *supra*, the Court of Appeals for the Third Circuit rejected a claim that the McCarran-Ferguson Act immunized a Pennsylvania statute prohibiting mergers between financial institutions and insurance companies. In rejecting the claim, the court emphasized that the "affiliation between insurers and banks has no integral connection to the relationship between the insured and the insurer." 792 F.2d at 364. Thus, the court concluded that laws such as Pennsylvania's "have no part in the business of insurance under McCarran-Ferguson." *Id*. <**NOTE:** The *Blackfeet* case briefly considered this point in the context of *issuance* by a national bank of an annuity-like product, the Retirement CD. However, in that situation, the bank's role as issuer of the instrument in question at least could be analogized to the role of an insurer in the insurance context. No such similarity exists when a bank is simply selling, as agent, an instrument issued by another entity.>

The effect of the Texas provisions at issue is to exclude national banks from participating in insurance agency activities, not to regulate the relationship between the insurer and the insured. Excluding national banks as a group from even qualifying to obtain licenses to sell annuities does not transfer or spread policyholder risk; it is not an integral part of the relationship between an insurer and its insured, and it is not aimed at a practice limited to entities within the insurance industry. As the Sixth Circuit, in *Owensboro*, correctly observed:

> [e]xcluding a person from participation in an activity . . . is different from regulating the manner in which that activity is conducted. The former is regulation of the person; the latter is regulation of the activity.

Owensboro, 44 F.3d at 392. Accordingly, the preemption shield of the McCarran-Ferguson Act does not apply to Texas's statutory prohibitions or to any limitation that would restrict the selling of annuities by national banks to banks located in places with 5,000 or fewer inhabitants, and those provisions must be analyzed according to traditional preemption analysis.

D. Preemption of State Laws that Conflict with a Federal Statute

To the extent that state law or other regulatory actions prohibit or impede national banks from exercising their federally-granted power to sell annuities as agent, the state action is preempted by section 24(Seventh). A state law in conflict with a federal statute is "without force," whether or not Congress has expressed an intent to preempt or has otherwise occupied the field regulated by the state. *See generally Barnett Bank of Marion County v. Nelson*, 517 U.S. ___, 134 L.Ed.2d 237 (1996); *CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 113 S. Ct. 1732, 1737 (1993); *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S. Ct. 2608, 2617 (1992); *MacDonald v. Mansanto Co.*, 27 F.3d 1021, 1023 (5th Cir. 1994). When such a conflict occurs, a state's claim that the area is one that it has traditionally regulated is immaterial. *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 153 (1982). A conflict between state and federal law can occur either because compliance with both state and federal law is a "physical impossibility," *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963), or because the state law stands "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). *See Barnett*, 116 S. Ct. at 1103.

The general principles of federal preemption apply with full force to state laws that affect the Federally-authorized activities of national banks. Since their creation, national banks have been recognized as appropriate "instruments designed to be used to aid the government in the administration of an important branch of public service." *Farmers' & Mechanics' Nat'l Bank v. Dearing*, 91 U.S. 29, 33 (1876). *See, e.g., First Nat'l Bank v. California*, 262 U.S. 366, 368-69 (1923); *Davis v. Elmira Sav. Bank*, 161 U.S. 275, 283 (1896). In applying federal preemption principles to conflicting state and federal laws that concern the conduct of national banks, the Supreme Court has long maintained that

> an attempt by a State to define [a national bank's] duties or control the conduct of [a national bank's] affairs is void whenever it conflicts with the laws of the United States or frustrates the purposes of the national legislation or impairs the efficiency of the bank to discharge the duties for which it was created.

Davis v. Elmira Sav. Bank, 161 U.S. at 283. *Accord Easton v. Iowa*, 188 U.S. 220, 238 (1903); *Owensboro Nat'l Bank v. Owensboro*, 173 U.S. 664, 667-68 (1899).

Finally, state statutes that limit a national bank power conflict with federal law even if the federal law does not impose a requirement, but merely provides authority to act. *Barnett*, 113 S. Ct. at 1108; *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 155 (1982); *Franklin Nat. Bank v. New York*, 347 U.S. 373, 375-379 (1954) (federal statute permitting, but not requiring, national banks to receive savings deposits, preempts conflicting prohibitory state statute). Instruction on this point is provided by *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 155 (1982), where the Supreme Court decided that California law restricting the exercise of "due-on-sale" mortgage clauses conflicted with a federal regulation generally permitting the use of such clauses by federal thrift institutions. The Court observed that the conflict was not eliminated because the federal regulation "permits, but does not compel," the inclusion of due-on-sale clauses, because the California restriction had effectively eliminated the ability of a federal savings and loan to provide for such clauses "at its option." *Id.* at 155.

As the Supreme Court explained in *Barnett*, Congressional grants of both enumerated and incidental powers to national banks are generally interpreted in the context of national bank legislation as grants of authority "not normally limited by, but rather ordinarily preempting, contrary state law." *Barnett*, 116 S. Ct. at 1108. The Court reasoned that in defining the preemptive scope of statutes and regulations granting a power to national banks, "normally Congress would not want States to forbid, or impair significantly, the exercise of a power that Congress explicitly granted." *Id.* But, as the Court in *Barnett* recognized "[t]o say this is not to deprive States of the power to regulate national banks, where doing so does not significantly interfere with the national bank's exercise of its powers." *Id.*<**NOTE:** As examples of this principle, the court cited *Anderson National Bank v. Luckett*, 321 U.S. 233, 247-252 (1944) (State statute administering abandoned deposit accounts did not unlawfully encroach on the rights and privileges of national banks; national banks are subject to state laws unless those laws infringe the national banking laws or impose an undue burden on the performance of national bank functions.); *McClellan v. Chipman*, 164 U.S. 347, 358 (1896) (Application to national banks of state statute forbidding certain real estate transfers by insolvent transferees would not destroy or hamper national banks' functions.); and *National Bank v. Commonwealth*, 76 U.S. (9 Wall.) 353, 362 (1869) (National banks subject to state law taxing bank shares that does not "interfere with, or impair [national banks'] efficiency in performing the function by which they are designed to serve [the Federal] Government.").>

Under this standard, therefore, Texas state laws that interfere with national banks' exercise of their power to sell annuities would *not* be preempted if the extent of the interference is *insignificant*. <**NOTE:** This test, and the cases cited by the Supreme Court, all reflect that the extent to which state law may diminish the ability of national banks to exercise their powers is limited, e.g., state law applies if it does not "*encroach*" on the rights of national banks; if the law would not "*hamper*," "*infringe*," or impose an "*undue burden*" on national bank functions; if the applicable state law would not "*impair the efficiency*" of those functions.> Clearly, that is not the case here. The state law provisions described at the outset of this letter would effectively prevent national banks from selling annuities. And, even if those provisions were read to allow annuities sales by national banks located in places with 5,000 or fewer inhabitants, the effect would, by any gauge, be a significant interference with the authority granted to national banks to sell annuities since some national banks (those not located in places with 5,000 or fewer inhabitants) would be prevented from selling annuities *at all*, and others would be precluded from basing their annuities sales in many locations. Accordingly, under either approach to the Texas state law at issue, the state law provisions would be preempted by section 24(Seventh) of the National Bank Act, which contains no such limitations on national banks' authority or eligibility to sell annuities.

E. Conclusion

To summarize, national banks have authority under the National Bank Act to sell annuities as agent. In our opinion, the McCarran-Ferguson Act does not shield from preemption Texas laws that wholly or partially prevent national banks from selling annuities for two reasons: (1) annuities are not "insurance" for purposes of the McCarran-Ferguson Act, and (2) the McCarran-Ferguson Act does not shield a state law that results in negating the Federally-authorized corporate power of national banks to sell annuities.

These conclusions do not, however, place annuities outside the scope of federal and state laws. Variable annuities are covered by federal securities laws, and both fixed and variable annuity sales by national banks will be subject to state laws that are not preempted under recognized standards of federal preemption. <**NOTE:** For example, as noted in section D, a state law would *not* be preempted if it did not prevent national banks from exercising their Federally authorized powers, and if the extent to which the law actually interfered with or impaired the ability of national banks to exercise those powers was insignificant.>

Very truly yours,
/s/
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